



COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

Retail Commodity Transactions under Commodity Exchange Act

RIN 3038-AD64

AGENCY: Commodity Futures Trading Commission.

ACTION: Interpretation; Request for Comments

SUMMARY: The Commodity Futures Trading Commission (“Commission” or “CFTC”) is issuing this interpretation of the term “actual delivery” as set forth in section 2(c)(2)(D)(ii)(III)(aa) of the Commodity Exchange Act (“CEA”) pursuant to section 742(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Commission requests comment on whether this interpretation accurately construes the statutory language. In the event that comments demonstrate a need to modify this interpretation, the Commission will take appropriate action.

DATES: Effective [INSERT DATE OF PUBLICATION IN FEDERAL REGISTER].

Comments must be received by [INSERT DATE 60 DAYS AFTER PUBLICATION IN FEDERAL REGISTER], 2012.

ADDRESSES: Comments, identified by RIN number, may be sent by any of the following methods:

- *Agency Website, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the website.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581.
- *Hand Delivery/Courier:* Same as mail above.

- *Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.*

FOR FURTHER INFORMATION CONTACT:

Rosemary Hollinger, Regional Counsel, Division of Enforcement, 312-596-0538, rhollinger@cftc.gov, or Martin B. White, Assistant General Counsel, Office of the General Counsel, 202-418-5129, mwhite@cftc.gov, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581.

All comments must be submitted in English, or, if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that may be exempt from disclosure under the Freedom of Information Act (“FOIA”),¹ a petition for confidential treatment of the exempt information may be submitted according to the established procedures in § 145.9 of the CFTC’s regulations.² The Commission reserves the right, but shall have no obligation, to review, prescreen, filter, redact, refuse, or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

SUPPLEMENTARY INFORMATION

¹ 5 U.S.C. § 552.

² 17 C.F.R. § 145.9.

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).³ Title VII of the Dodd-Frank Act⁴ amended the Commodity Exchange Act (“CEA”)⁵ to establish a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission’s rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission’s oversight.

In addition, section 742(a) of the Dodd-Frank Act amends section 2(c)(2) of the CEA to add a new subparagraph, section 2(c)(2)(D) of the CEA,⁶ entitled “Retail Commodity Transactions.” New CEA section 2(c)(2)(D) provides the Commission with a new source of jurisdiction over certain retail commodity transactions.⁷ Congress enacted this provision following court decisions, including *CFTC v. Zelener*,⁸ that narrowly interpreted the term “contract of sale of a commodity for future delivery”—the statutory term for a futures contract—

³ See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Public Law 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

⁴ Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the “Wall Street Transparency and Accountability Act of 2010.”

⁵ 7 U.S.C. § 1 *et seq.*

⁶ 7 U.S.C. § 2(c)(2)(D).

⁷ The jurisdictional grant provided to the Commission by new CEA section 2(c)(2)(D) is in addition to, and independent from, the jurisdiction over contracts of sale of a commodity for future delivery and transactions subject to regulation pursuant to CEA section 19 that the CEA has historically granted to the Commission. The jurisdictional grant provided by new CEA section 2(c)(2)(D) is also in addition to, and independent from, the jurisdiction over swaps granted to the Commission by the Dodd-Frank Act.

⁸ 373 F.3d 861 (7th Cir. 2004); *see also CFTC v. Erskine*, 512 F.3d 309 (6th Cir. 2008).

based on language in customer agreements. *Zelener* involved retail foreign currency transactions that were characterized as spot sales in contract documents, but in which, in practice, customer positions were held open indefinitely and customers never took delivery of foreign currency.⁹ *Zelener* held that the transactions were not subject to CFTC jurisdiction because they did not involve futures contracts but were “in form, spot sales for delivery within 48 hours.”¹⁰ In so ruling, the court focused solely on the language of the customer agreements.

Following *Zelener*, Congress provided the Commission with additional authority over retail foreign currency transactions in the CFTC Reauthorization Act of 2008.¹¹ Similarly, in section 742(a) of the Dodd-Frank Act, Congress provided the Commission with additional authority over non-foreign currency retail commodity transactions by making specified forms of these transactions subject to certain provisions of the CEA regardless of whether they involve a “contract of sale of a commodity for future delivery.” Senator Lincoln explained the rationale for this legislation during floor debate on the Dodd-Frank Act:

[the] contracts [in *Zelener*] function just like futures contracts, but the court of appeals, ...based on the wording of the contract documents, held them to be spot contracts outside of CFTC jurisdiction. The CFTC Reauthorization Act of 2008, which was enacted as part of that year’s Farm Bill, clarified that such transactions in foreign currency are subject to CFTC anti-fraud authority. It left open the possibility, however, that such *Zelener*-type contracts could still escape CFTC jurisdiction if used for other commodities such as energy and metals.

⁹ 373 F.3d at 863-64.

¹⁰ *Id.* at 868-69.

¹¹ Food, Conservation and Energy Act of 2008, Public Law 110-246, 122 Stat. 1651 (2008).

Section 742 corrects this by extending the Farm Bill’s “Zelener fraud fix” to retail off-exchange transactions in all commodities. Further, a transaction with a retail customer that meets the leverage and other requirements set forth in Section 742 is subject not only to the anti-fraud provisions of CEA Section 4b (which is the case for foreign currency), but also to the on-exchange trading requirement of CEA Section 4(a), “as if” the transaction was a futures contract.¹²

Accordingly, new CEA section 2(c)(2)(D) broadly applies to any agreement, contract, or transaction in any commodity that is entered into with, or offered to (even if not entered into with), a non-eligible contract participant or non-eligible commercial entity on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.¹³ New CEA section 2(c)(2)(D) further provides that such an agreement, contract, or transaction shall be subject to CEA sections 4(a),¹⁴ 4(b),¹⁵

¹² 156 CONG. REC. S5,924 (daily ed. July 15, 2010) (statement of Sen. Lincoln); *see also Hearing to Review Implications of the CFTC v. Zelener Case Before the Subcomm. on General Farm Commodities and Risk Management of the H. Comm. on Agriculture*, 111th Cong. 52-664 (2009) (“In 2004 the Seventh Circuit Court made a decision in the *CFTC v. Zelener* [case]. It adopted a narrow definition of the term ‘transactions for future delivery.’ What it held is that a 3-day contract offered to retail customers for foreign currency that on its face promised delivery was not a futures contract and was, therefore, outside the CFTC’s jurisdiction. This was even though the contracts operated in practice as futures contracts. Following the *Zelener* decision, many [fraudsters] were given a roadmap to evade CFTC jurisdiction and to scam customers or consumers.”) (statement of Hon. Leonard L. Boswell, United States Representative and Chairman, Subcommittee on General Farm Commodities and Risk Management); (“What we are talking about here though is expanding the—well, correcting would be the argument the *Zelener* interpretation of what a futures contract is. If in substance it is a futures contract, it is going to be regulated. It doesn’t matter how clever your draftsmanship is.”) (statement of Hon. Jim Marshall, United States Representative).

¹³ 7 U.S.C. § 2(c)(2)(D)(i).

¹⁴ 7 U.S.C. § 6(a).

¹⁵ 7 U.S.C. § 6(b).

and 4b¹⁶ “as if the agreement, contract, or transaction was a contract of sale of a commodity for future delivery.”¹⁷

New CEA section 2(c)(2)(D) excepts certain transactions from its application. In particular, new CEA section 2(c)(2)(D)(ii)(III)(aa)¹⁸ excepts a contract of sale that “results in actual delivery within 28 days or such other longer period as the Commission may determine by rule or regulation based upon the typical commercial practice in cash or spot markets for the commodity involved.”¹⁹

The Commission is issuing this interpretation to inform the public of the Commission’s views as to the meaning of the term “actual delivery” as used in new CEA section 2(c)(2)(D)(ii)(III)(aa) and to provide the public with guidance on how the Commission intends to assess whether any given transaction results in actual delivery within the meaning of the statute.²⁰ The Commission requests comment on whether its interpretation of “actual delivery” accurately construes the statutory language.

¹⁶ 7 U.S.C. § 6b.

¹⁷ 7 U.S.C. § 2(c)(2)(D)(iii).

¹⁸ 7 U.S.C. § 2(c)(2)(D)(ii)(III)(aa).

¹⁹ The Commission has not adopted any regulations permitting a longer actual delivery period for any commodity pursuant to new CEA section 2(c)(2)(D)(ii)(III)(aa). Accordingly, the 28-day actual delivery period set forth in this provision remains applicable to all commodities.

²⁰ In 1985, the Commission’s Office of General Counsel issued a staff interpretation determining whether certain hypothetical precious metals transactions would be subject to regulation under the CEA. Interpretive Letter 85-2, *Bank Activities Involving the Sale of Precious Metals* (CFTC Office of General Counsel Aug. 6, 1985), Comm. Fut. L. Rep. (CCH) ¶ 22,673 (“Letter 85-2”). Letter 85-2 opined on whether the hypothetical transactions would constitute leverage contracts, as defined by 17 C.F.R. § 31.4(w), or contracts of sale of a commodity for future delivery, as that term is used in CEA section 2(a)(1)(A). Letter 85-2 is not relevant to a determination of whether “actual delivery” has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa) for several reasons, including, but not limited to, the following: (1) Letter 85-2 predates new CEA section 2(c)(2)(D) by approximately 26 years and therefore does not purport to construe new CEA section 2(c)(2)(D); (2) to the extent Letter 85-2 assumes the occurrence of delivery of a commodity, it does not purport to determine whether “actual delivery” has occurred under new CEA section 2(c)(2)(D)(ii)(III)(aa); and (3) new CEA section 2(c)(2)(D)(iii) explicitly subjects certain retail commodity transactions to CEA sections 4(a), 4(b), and 4b “as if” they were contracts of sale of a commodity for future delivery, regardless of whether they are, in fact, contracts of sale of a commodity for future delivery under CEA section 2(a)(1)(A).

This interpretation does not address the meaning or scope of new CEA section 2(c)(2)(D)(ii)(III)(bb)²¹ or any exception to new CEA section 2(c)(2)(D) other than new CEA section 2(c)(2)(D)(ii)(III)(aa). Similarly, this interpretation does not address the meaning or scope of contracts of sale of a commodity for future delivery, the forward contract exclusion from the term “future delivery” set forth in CEA section 1a(27),²² or the forward contract exclusion from the term “swap” set forth in CEA section 1a(47)(B)(ii).²³ Nor does this interpretation alter any statutory interpretation or statement of Commission policy relating to the forward contract exclusion.²⁴

II. Commission Interpretation of “Actual Delivery”

In the view of the Commission, the determination of whether “actual delivery” has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa) requires consideration of evidence regarding delivery beyond the four corners of contract documents. This interpretation of the statutory language is based on Congress’s use of the word “actual” to modify “delivery” and on the legislative history of new CEA section 2(c)(2)(D)(ii)(III)(aa) described above. Consistent with this interpretation of the statutory language, in determining whether actual delivery has occurred within 28 days, the Commission will employ a functional approach and examine how the agreement, contract, or transaction is marketed, managed, and performed, instead of relying solely on language used by the parties in the agreement, contract, or transaction. This approach best accomplishes Congress’s intent when it enacted section 742(a) of the Dodd-Frank Act and gives full meaning to Congress’s term “actual delivery.”

²¹ 7 U.S.C. § 2(c)(2)(D)(ii)(III)(bb).

²² 7 U.S.C. § 1a(27).

²³ 7 U.S.C. § 1a(47)(B)(ii).

²⁴ *See, e.g.*, Statutory Interpretation Concerning Forward Transactions, 55 FR 39188 (Sept. 25, 1990) (“Brent Interpretation”).

Relevant factors in this determination include the following: ownership, possession, title, and physical location of the commodity purchased or sold, both before and after execution of the agreement, contract, or transaction; the nature of the relationship between the buyer, seller, and possessor of the commodity purchased or sold; and the manner in which the purchase or sale is recorded and completed. The Commission provides the following examples to illustrate how it will determine whether actual delivery has occurred within the meaning of new CEA section 2(c)(2)(D)(ii)(III)(aa).

Example 1: Actual delivery will have occurred if, within 28 days, the seller has physically delivered the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, into the possession of the buyer and has transferred title to that quantity of the commodity to the buyer.

Example 2: Actual delivery will have occurred if, within 28 days, the seller has physically delivered the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, whether in specifically segregated or fungible bulk form, into the possession of a depository other than the seller and its parent company, partners, agents, and other affiliates, that is: (a) a financial institution as defined by the CEA; (b) a depository, the warrants or warehouse receipts of which are recognized for delivery purposes for any commodity on a contract market designated by the Commission; or (c) a storage facility licensed or regulated by the United States or any United States agency, and has transferred title to that quantity of the commodity to the buyer.²⁵

²⁵ Based on Examples 1 and 2, an agreement, contract, or transaction that results in “physical delivery” within the meaning of section 1.04(a)(2)(i)-(iii) of the Model State Commodity Code would ordinarily result in “actual delivery” under new CEA section 2(c)(2)(D)(ii)(III)(aa), absent other evidence indicating that the purported delivery is a sham. *See* Model State Commodity Code § 1.04(a)(2)(i)-(iii), Comm. Fut. L. Rep. Archive (CCH) ¶ 22,568 (Apr. 5, 1985). Conversely, an agreement, contract, or transaction that does not result in “physical delivery” within

Example 3: Actual delivery will *not* have occurred if, within 28 days, a book entry is made by the seller purporting to show that delivery of the commodity has been made to the buyer and/or that a sale of a commodity has subsequently been covered or hedged by the seller through a third party contract or account, but the seller has not, in accordance with the methods described in Example 1 or 2, physically delivered the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, and transferred title to that quantity of the commodity to the buyer, regardless of whether the agreement, contract, or transaction between the buyer and seller purports to create an enforceable obligation on the part of the seller, or a parent company, partner, agent, or other affiliate of the seller, to deliver the commodity to the buyer.

Example 4: Actual delivery will *not* have occurred if, within 28 days, the seller has purported to physically deliver the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, in accordance with the method described in Example 2, and transfer title to that quantity of the commodity to the buyer, but the title document fails to identify the specific financial institution, depository, or storage facility with possession of the commodity, the quality specifications of the commodity, the identity of the party transferring title to the commodity to the buyer, and the segregation or allocation status of the commodity.

Example 5: Actual delivery will *not* have occurred if, within 28 days, an agreement, contract, or transaction for the purchase or sale of a commodity is rolled, offset, or otherwise netted with another transaction or settled in cash between the buyer and the seller, but the seller has not, in accordance with the methods described in Example 1 or 2, physically delivered the

the meaning of section 1.04(a)(2)(i)-(iii) of the Model State Commodity Code is highly unlikely to result in “actual delivery” under new CEA section 2(c)(2)(D)(ii)(III)(aa).

entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing, and transferred title to that quantity of the commodity to the buyer, regardless of whether the agreement, contract, or transaction between the buyer and seller purports to create an enforceable obligation on the part of the seller, or a parent company, partner, agent, or other affiliate of the seller, to deliver the commodity to the buyer.

Issued in Washington, D.C., on December 1, 2011 by the Commission.

David A. Stawick,

Secretary of the Commission.

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